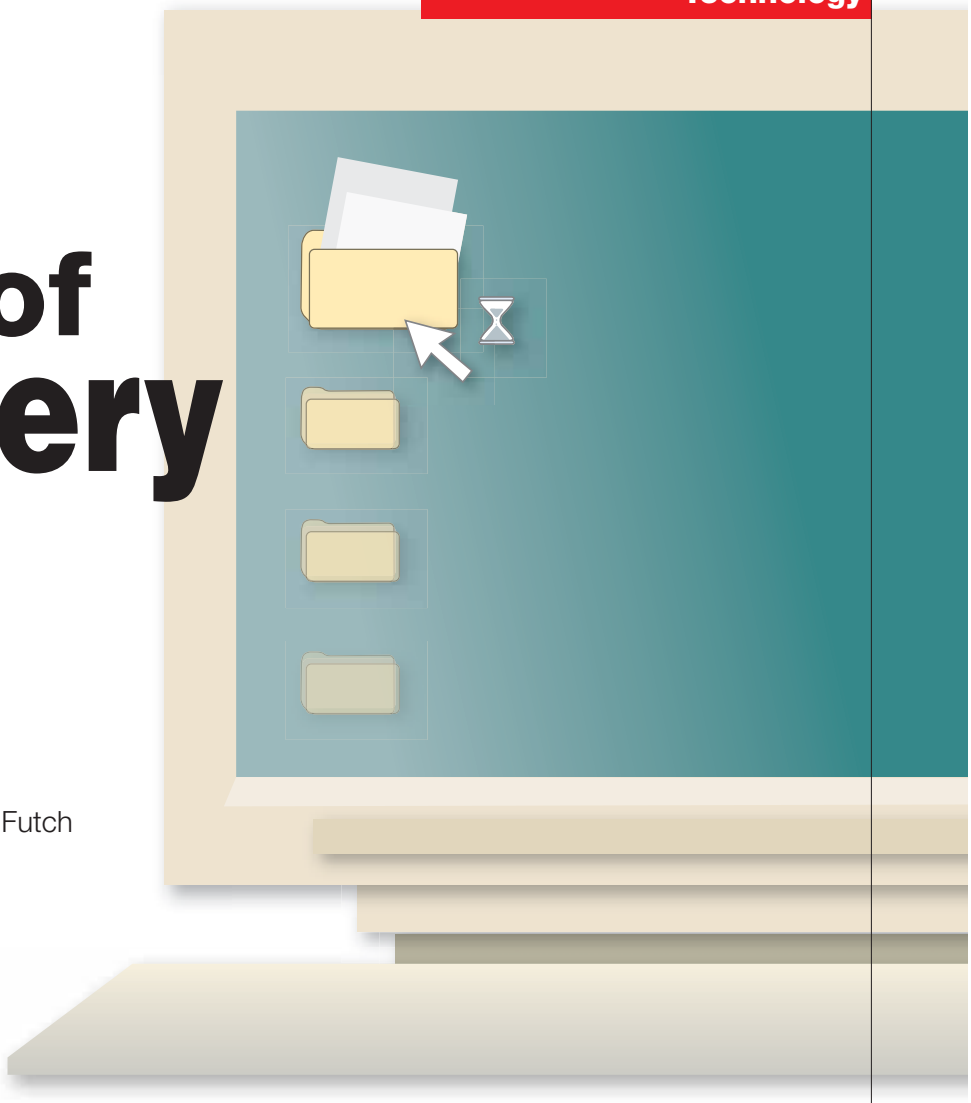
The Cost of Discovery



Insurers must know the new litigation rules concerning electronically stored information or pay the price.

by H. Christopher Boehning and Aaron Futch

Illustration by Ellen Wagner

Nonparty discovery is a common feature in insurance litigation. An insurance company defending against a property or business income coverage claim may need to subpoena documents from third parties who have business relationships with the insured. And insurance companies receive subpoenas in all manner of actions, including claims between an insured and the insured's broker. Whether responding to or serving subpoenas, insurance companies should be alert to the impact that the changes to Rule 45 of the Federal Rules of Civil Procedure will have on the obligations of nonparties to produce electronically stored information.

The Two Faces of Rule 45

The vast majority of attention that has been paid to the Dec. 1, 2006, Federal Rules of Civil Procedure amendments has focused on the impact of the rules on party discovery. But the amendments also require nonparties—and parties serving subpoenas on nonparties—to confront the challenges of requests for electronically stored information.

Amended Rule 45 provides a useful overview of the changes made elsewhere in the Federal Rules, as it incorporates in a single rule the changes made to several party-discovery provisions dealing with sampling and testing large data sets, specifying the format of electronic production, recovering inaccessible data, and reclaiming inadvertently produced privileged documents. As with the changes made to party discovery under Rule 34, requests made to nonparties for "documents" should now be "understood to encompass, and the response should include, electronically stored information unless discovery in the action has clearly distinguished between electronically

Key Points

- Amendments to Rule 45 of the Federal Rules of Civil Procedure may cause potential costs and burdens to nonparties who are requested to provide electronic documents.
- When issuing subpoenas insurers should be prepared for the likelihood that nonparties will demand that insurers pay the cost of producing electronically stored information.
- The courts still lack guidance in ruling who should pay for nonparty e-discovery.

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stored information and 'documents.'" Thus, it is no longer an answer for nonparties to argue that electronic discovery is per se unduly burdensome.

Nonetheless, it remains true that the potential costs and burdens that nonparties will face in dealing with electronically stored information raise distinct issues that are not often prominent in party discovery. For one thing, parties that issue subpoenas must always be conscious of their obligation under Rule 45 to "take reasonable steps to avoid imposing undue burden or expense on a person subject to that subpoena." That obligation may in theory (though rarely in practice) be enforced by the court through sanctions including attorneys' fees.

For another thing, parties that issue subpoenas should be aware that courts are much more willing to shift the costs of production from the responding party to the requesting party in cases where the requesting party has not sufficiently protected the producing party from "undue burden or expense." And despite expanding the scope of Rule 45 to encompass electronically stored information, the amended rules now provide nonparties two chances to argue in appropriate cases that those burdens are undue. First, there is the traditional and familiar provision of Rule 45(c) that protects nonparties from "undue burden or expense" when responding to subpoenas. If a nonparty files timely objections to a subpoena, an order to compel production is required, and such orders "shall protect [nonparties] from significant expense[.]" This rule permits the shifting of costs from the producing party to the requesting party.

Second, amended Rule 45 incorporates the provisions of new Rule 26(b)(2)(B) and permits nonparties to resist producing electronically stored information that is "not reasonably accessible because of undue burden or cost." If a court orders production of the electronically stored information anyway—because, for example, the information is available from no other source—then the court "may specify conditions for the discovery," which could, presumably, include cost shifting as well.

It is unclear how these two standards will operate together and whether challenges of undue burden will carry much weight now that amended Rule 45 expressly contemplates the production of electronically stored information. In the past, trial courts have exercised significant discretion to determine what constitutes "undue burden or expense."

Shifting Costs

Insurance companies should be aware that, whether they are responding to subpoenas as nonparties or issuing subpoenas on their own behalf, in the area where nonparties are most likely to incur significant costs—attorney's fees resulting from reviewing documents for responsiveness and privilege—there are arguments to be made that these costs should shift from producing parties to requesting parties.

It is clear that courts have the authority to shift attorney-review costs from nonparty subpoena recipients onto requesting parties, and in the world of paper discovery such shifting did happen. In *In re Application of the Law Firms of McCourts and McGrigor Donald,* the court used a three-factor test—(1) whether the nonparty actually had an interest in the outcome of the litigation, (2) whether the nonparty could more readily bear the costs than the requesting party, and (3) whether the litigation was of public importance—to find that the requesting party should foot the entire bill for a nonparty's review of documents by outside counsel.

Nonetheless, this kind of cost-shifting of attorneys' fees has been slow to manifest itself in the world of electronic discovery. Indeed, our research has revealed only one case in which a court shifted attorneys' fees associated with production of electronically stored information, and that decision involved no in-depth discussion of the issue (*In re Auto. Refinishing Paint*).

Lessons from *Zubulake*

Despite the paucity of current authority on this issue with respect to nonparties, cases from the context of party discovery, such as the seminal *Zubulake v. UBS Warburg LLC*.case, provide a roadmap for how nonparties might construct such arguments.

At first blush, it might seem odd to look for guidance on the subject of cost shifting for nonparties (and especially cost shifting of attorney time) in *Zubulake.* After all, the *Zubulake* court expressly rejected any suggestion that the requesting party should pay the producing party's attorney's fees, stating that the producing party "should always bear the cost of reviewing and producing electronic data . . . [because] the producing party has the exclusive ability to control the cost of reviewing the documents."

But whether or not one agrees with that view in the context of party discovery, courts could adopt a similar burden-shifting analysis (minus the prohibition on consideration of attorney review time) when considering cost shifting for nonparties served under Rule 45.

The *Zubulake* court stated that the following seven factors should be part of any cost-shifting analysis:

1. The extent to which the request is specifically tailored to discover relevant information;
2. The availability of such information from other sources;
3. The total cost of production, compared to the amount in controversy;
4. The total cost of production, compared to the resources available to each party;
5. The relative ability of each party to control costs and its incentive to do so;
6. The importance of the issues at stake in the litigation; and
7. The relative benefits to the parties of obtaining the information.

The first two of these factors have particular relevance to the nonparty context. Discouraging overly broad subpoenas that are not specifically tailored to the nonparty's circumstances is a key rationale behind

the cost-shifting mechanism of Rule 45. Likewise, if documents sought by a requesting party are available from alternate sources—and particularly if they're available from a party to the litigation—courts are sympathetic to nonparties' argument that it's unduly burdensome to produce such documents.

Several of the other *Zubulake* factors bear some resemblance to the three-factor test in *McCourts*. For example, the last factor—the relative benefits to the parties—is a close analog to the first *McCourts* factor—whether the nonparty has an interest in the outcome of the litigation. The more closely the nonparty is involved in the subject matter of the litigation, the more likely that the nonparty will have to pay its own attorney's fees.

Similarly, the fourth *Zubulake* factor—the relative resources of the parties—is comparable to the second *McCourts* factor: whether the nonparty could more readily bear the costs than the requesting party. And the sixth factor under the *Zubulake* analysis—the importance of the litigation—parallels the final *McCourts* factor: whether the litigation is of public importance. All of these factors should carry the same weight under *Zubulake* that they had in *McCourts*.

Thus, the cost-shifting lessons of *Zubulake* could offer significant insights as courts consider nonparties' cost-shifting requests in the e-discovery context. And because the presumption that producing parties must bear their own review costs does not necessarily hold true in the nonparty context, the *Zubulake* court's outright rejection of attorney-review cost shifting in the circumstances of that case is not a bar to shifting such costs once amended Rule 45 takes effect.

Be Prepared

As insurance companies begin to address the changes to Rule 45, they should keep in mind these cost-shifting arguments. When responding to subpoenas, insurance companies may be able to invoke this rationale to lessen the financial sting of collecting and producing huge amounts of electronically stored information. When issuing subpoenas, however, insurance companies should be prepared for the likelihood that nonparties will become increasingly aggressive in demanding cost-shifting as the burdens of producing electronically stored information become apparent.

Until there is a better-developed body of case law in this area, insurance companies should follow the guidance provided elsewhere in the amendments to the Federal Rules—confer with the opposing party. It's usually preferable to work out an agreement on these issues than to leave it to the discretion of the court. Because courts still lack guidance in crafting such orders in the e-discovery world, it's tough to predict what kind of decision will result, and in particular whether attorneys' fees will be reimbursed. BR